

FINAL STATEMENT OF REASONS
FOR RULE CHANGES UNDER THE
CORPORATE SECURITIES LAW OF 1968

As required by Section 11346.2 of the Government Code, the Commissioner of Corporations ("Commissioner") sets forth below the reasons for the proposed amendment to Section(s) of the California Code of Regulations (10 C.C.R. Sec.).

Rule 260.105.11 (10 C.C.R. Sec. 260.105.11) provides a non-issuer exemption from the qualification requirements of the Corporate Securities Law of 1968 ("CSL") for securities of foreign-country issuers where certain requirements are met. This non-issuer or "trading" exemption from the requirements of Corporations Code Section 25130 applies to: (1) those issuers currently filing with the Securities and Exchange Commission ("SEC") information and reports pursuant to Section 15(d) of the Exchange Act of 1934; (2) those securities appearing in the most recent Federal Reserve Board List of Foreign Margin Stocks (the "List"); and (3) those issuers not subject to the reporting requirements of Section 13 or 15(d) of the Securities Act of 1934 where the issuer meets certain "worldwide" issuer requirements.

The Commissioner proposes amendments to subsection (a) of Rule 260.105.11 to take into account the method used by the Board of Governors of the Federal Reserve System ("the Board") to identify foreign margin stocks.

Currently, subsection (a) of Rule 260.105.11 exempts any foreign equity security on the List of Foreign Margin Stocks published by the Federal Reserve Board (the "List") from the qualification for secondary trading in this state because it does not fall within the purposes of the CSL and its qualification is not necessary or appropriate in the public interest or for the protection of investors.

Background

Since 1990, the Board has published a List of foreign equity securities eligible for margin. According to Regulation T, foreign equity securities are initially eligible for inclusion on the List if the issuer meets certain threshold criteria relating to trading volume, trading history, and market capitalization. The issuer must maintain a minimum level of trading volume and market value in order for the securities to continue to be eligible. (The requirements for inclusion and continued inclusion of foreign equity securities on the List are found at Rule 220.11(c) and (d) of Regulation T (12 CFR 220.11(c) and (d)).

In 1996, the Board included all foreign equity securities on the Financial Times/Standard & Poor's World Actuaries Indices ("FTS&P Indices") on the List in reliance upon a "no-action" letter issued by the SEC. This inclusion effectively treats all foreign equity securities on the FTS&P Indices as having a "ready market" for the purposes of Rule 15c3-1 of the Securities

Exchange Act of 1934, as amended¹ (17 C.F.R. Sec. 240.15c3-1) (“Rule 15c3-1” or the “Net Capital Rule”), and exempt from the qualification requirements by Rule 260.105.11.

The Board recently amended its approach for determining which foreign stocks are eligible for extension of margin credit. Effective April 1, 1998, the definition of foreign margin stock in Section 220.2 of Regulation T (12 C.F.R. 220.2) was revised to include (in addition to foreign equity securities appearing on the List), foreign equity securities deemed have a “ready market” under Rule 15c3-1 or a “no-action” letter issued by the SEC regarding its “ready market” criteria.

The Board’s change allows a stock appearing on the FTS&P Indices to qualify as a margin security without the need to be included on the List. The Board’s action allows the inclusion of hundreds of additional foreign stocks on the List, based on a “no action” position from SEC that effectively treats all stocks on the FTS&P Indices as having a “ready market” for capital purposes. In the Board’s view, the process of increasing the coverage of its definition of margin security is an incremental one. The Board also believes that it is appropriate to limit the margin status of foreign stocks to those that either meet the Board’s original criteria for foreign margin stock which appears on the Board’s List or are determined by SEC to have a “ready market” for purposes of their net capital rule.

Since the Board’s definition of foreign margin stock has changed, the FTS&P Indices and any foreign equity securities with a “ready market” are no longer included on the List. Current Rule 260.105.11 may be interpreted to mean that FTS&P Indices and other foreign equity securities formerly on the List are no longer exempt from qualification pursuant to this rule.

Therefore, the proposed changes are necessary to conform Rule 260.105.11 to the Board’s current position with respect to foreign margin stock; and to restore the exemption from qualification for foreign equity securities listed on FTS&P Indices and other foreign equity securities under Rule 260.105.11.

ALTERNATIVES CONSIDERED

No alternative considered by the Department would be more effective in carrying out the purpose for which the regulation is proposed, would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses.

¹ *As defined by Rule 15c-13-1(c)(11) “ready market” includes a recognized established securities market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotation can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom “*

“Ready market” exists where securities have been accepted as collateral by a bank where the broker-dealer can demonstrate that the excess of market value of the securities over the amount of the loan is sufficient to make the loan acceptable as a fully secured loan to banks regularly making secured loans to brokers and dealers.

FISCAL IMPACT

Cost to Local Agencies and School Districts required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code: None. No other nondiscretionary cost or savings are imposed on local agencies.

DETERMINATIONS

The Commissioner has determined that the proposed regulatory action does not impose a mandate on local agencies or school districts, which require reimbursement pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

ADDENDUM REGARDING PUBLIC COMMENTS

One comment was received during the public comment period which ended on December 17, 1999. No request for public hearing was received. No public hearing was scheduled or heard.

COMMENTOR: Ellen A. Scanlon, First Vice President, Compliance Department, Prudential Securities, Inc., dated November 18, 1999, writes in support of the proposed regulation change.

No comments were received after the close of the comment period.